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Measuring brand value in today's market

(First of two parts)

There are two primary drivers of value in a winery sales transaction – the value of the real estate and improvements, and the value of the brand and associated inventory. Some of the more notable wine industry transactions demonstrate that a successful brand can achieve stunning financial returns, even where the selling winery may have owned little to no real estate.

In particular, the sales of Williams Selyem to Pebble Ridge Vineyards, Rosenblum Cellars to Diageo, Murphy Goode Estate to Kendall Jackson and, more recently, Kosta Browne to the Vincraft Group illustrate successful business models where value was created independent of real estate.

These "virtual" wineries did not have significant vineyard holdings and either leased their production facilities or out sourced their wine production needs. For the most part, the winery's assets consisted of a brand (i.e., the label and trademarks), inventories of cased goods and bulk wine, proprietary customer lists and, perhaps, some winery equipment, tanks and barrels.

So, how does one determine the value of a brand and inventory? There are two generally recognized methods: the asset valuation method, which values a brand and inventory by aggregating its separate asset components, and the cash flow analysis method, which values a brand and inventory based on the stream of income that it produces.

This first of two articles will examine the asset valuation method, and part two will review the cash flow analysis method. Throughout the remainder of this article, the term "brand" will refer to both the intangible components of a brand (trademark, goodwill, etc.) and the tangible components (wine inventory).

The asset valuation method is largely applicable to (i) start-up wine brands and (ii) brands that may be struggling in their attempts to build a strong and stable stream of sales revenue and profits. Today's severe economic climate and its resulting depression on wine sales and profit margins have made the asset valuation method a more common means of valuing brands.

Valuation of "tangible assets" using the asset valuation method

The core component of the asset valuation method is a valuation of the "tangible assets" associated with the brand – its inventory of cased goods and bulk wine. Typically, a seller assumes that its wine inventory will be valued at its FOB (free on board) sales price. Yet, such a valuation metric would leave a buyer without any margin for profit and ancillary expenses related to the sale of the inventory.

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Therefore, the wine inventory is typically valued on a "net realizable value" basis. This valuation methodology assumes an initial value of the inventory at average sales prices, which is a weighted average of FOB and retail sales prices based on the winery's distribution channel mix. Thereafter, items such as profit margin, sales expenses and administrative expenses are deducted from the initial value of the cased goods inventory in order to arrive at a net value if a buyer were to sell the cased goods inventory in the marketplace in the ordinary course of business.

Additionally, the winery's bulk wine inventory is converted to a cased goods equivalent, less the production and packaging costs associated with converting the wine from bulk to cased goods. The cased goods equivalent inventory is also calculated on a net realizable value basis, meaning that once the wine inventory is converted to a cased goods equivalent value, the net value of the cased goods inventory is determined by factoring in margins for profit, as well as sales and administrative expenses.

A key underlying assumption behind the valuation of a brand's tangible assets is that, going forward, all of the inventory will be sold at average sales prices. Given the current economic environment, there must be a compelling rationale to support such sales assumptions; otherwise the sales assumptions must be discounted.

Valuation of "intangible assets" using the asset valuation method

Once the tangible assets have been valued, special consideration should be given to whether the brand has "intangible assets" that have not been fairly accounted for using the net realizable value calculation.

In particular, consideration should be given to the strength or uniqueness of trademarks (e.g., international registrations or appellation-specific marks), proprietary customer lists and the business' assembled work force and existing infrastructure.

Under the asset valuation method, the value of separately identifiable intangible assets is arrived at by using the cost approach or, more specifically, the cost to recreate or replace the existing intangible assets. A proper accounting for such intangible assets can add significant value to the overall valuation of a brand where such value may not be readily apparent. For example, a 5,000-member wine club list would likely attract significant interest from prospective acquirers due to the relatively high profit margins on consumer direct sales and the challenges of selling wine through the three-tiered wholesale distribution system.

The asset valuation method typically provides a solid starting point for valuing a brand. However, it may not entirely capture the value of the brand with large, positive cash flows. In this case the cash flow analysis method, the subject of our next article, may be a better approach.

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